



Brief Description of Topic: Price Post and Hold Regulation – Next Steps

Date: April 2, 2008

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DESCRIPTION OF ISSUE

The 9th Circuit Court of Appeals ruled the Liquor Control Board's (LCB) price posting and 30-day hold period violated federal anti-trust laws. Without this enforcement tool, the LCB needs to decide how to efficiently enforce uniform pricing.

BACKGROUND

In February 2004, Costco filed a federal court challenge to several key regulations of the state's three-tier system of beer and wine distribution. Costco argued the requirements violate federal anti-trust laws. Nine specific restraints were challenged.

1. Uniform Pricing (manufacturers must offer uniform prices to distributors who must offer uniform prices to all retailers).
2. **Price Posting** (prices posted electronically with state and may be viewed when price is in effective period at kiosk).
3. **Price Holding** (electronically posted prices adhered to for 30 days).
4. Minimum Mark Up (selling price at least 10% over posted price).
5. Ban on Quantity Discounts (no price break for volume purchases).
6. Ban on Credit (no distributor sales on credit to retailers).
7. Delivered Pricing (price to retailer includes cost of delivery, even if delivery declined).
8. Ban on Central Warehousing (deliver only to licensed retail location).
9. Ban on Retail-to-Retail Sales (retailers cannot sell to other retailers). (State won this outright).

In March 2006, all the regulations were struck down except the ban on retail-to-retail sales. The LCB appealed the decision and in January 2008, the three-judge panel of the 9th Circuit Court found all the regulations—except price post and hold requirements—were valid and did not violate federal anti-trust laws. The panel noted that most of the challenged restraints were for the purpose of reinforcing uniform pricing. Costco has petitioned for review of the decision by the full 11 member panel of the 9th Circuit Court.

The Board instructed staff to develop options for enforcing uniform pricing without the price post and hold regulations.

PROCESS

LCB staff contacted other states and via e-mail using the National Alcohol Beverage Control Association (NABCA). The purpose was to determine if other states require price post or price hold and how they regulate prices. Based on the data collected:

A total of 39 states (excluding Washington) provided information about price posting, price hold, and uniform pricing.

- 27 states require price posting (mixture of beer, wine, spirits).
- 13 states require a price hold which varies from 10 to 90 days.
- 13 states require uniform pricing.
- Five states have a combination of all three elements (California, Idaho*, Maryland, Missouri, New Hampshire*).
- Not a lot of information on enforcement was provided. In general, most states do not enforce price but Maryland audits distributor prices to verify it matches the filed price.

*control states

Details on the capability of the LCB's electronic price post and hold system were discussed with Information Technology staff. In general, system enhancements can be made within 60 days.

OPTIONS CONSIDERED

To respond to the 9th Circuit ruling, the LCB staff considered various options such as:

- Use the current electronic system without holding prices for a period of time and take a proactive enforcement approach.
- LCB set prices at the distributor level.
- Supplier and distributor file prices in the electronic system and notify LCB only when a price changes.
- Abandon the current price post and hold electronic system and respond to complaints only. Monitor impact to price.

After reviewing the options and talking with other states, the LCB developed a proposal to enforce uniform pricing. At the February 20, 2008 Board meeting, the LCB presented a document describing "Costco v Hoen: Next Steps." The document outlines timelines for possible court action on Costco's request for a rehearing by the 9th Circuit Court. The document also presented an enforcement approach the LCB was considering.

- Eliminate the hold period and allow prices to be changed as often as desired but prices must be submitted electronically to the LCB.
- Price reductions maintained for 14 days or more are presumed to allow all interested parties to purchase at the reduced price.
- Price increases that occur less than 14 days after a price reduction will trigger closer scrutiny by the LCB and may give rise to enforcement action.
- LCB will employ additional methods to track and enforce compliance with the minimum mark-up and uniform pricing requirements through activities such as scheduled audits, random audits, and complaint driven audits.

Stakeholders were asked to give feedback on the approach presented. Responses were received from the Washington Restaurant Association, California Wine Institute, Northwest Grocery Association, Washington Food Industry, Washington Beer and Wine Wholesalers, and Costco. Of those organizations opposed to the option presented, three of them felt the action would not comply with the court's order. Other responses included:

- Price filing is a burden.
- Post and hold should be eliminated.
- Auditing and other practices could be used in lieu of an electronic reporting system to ensure compliance.
- Manufacturers and distributors should file prices when new products are added or when prices change.
- Suppliers should post prices before distributors.
- Use the last prices posted under the current system when converting to a new reporting system. This would create the "initial" price in the system.

RECOMMENDATION

In order to ensure an efficient enforcement tool is available to maintain uniform pricing, the LCB should use the current electronic price file system to capture supplier and distributor prices (by product code). Random audits will be used to supplement information provided by the electronic system.

The system should be modified to allow suppliers and distributors to continue to enter prices. Suppliers and distributors should only be able to view prices they enter into the system. Eliminate the hold period and allow prices to be changed as often as needed. Capturing price information provides a "starting point" for enforcement staff to use to monitor prices and take action to investigate potential violations of LCB regulations as needed. A computer file or report will be generated to reflect prices over a 14 day rolling period to monitor price fluctuations. A visual diagram of this process is shown on page 5.

If an investigation is required, invoices will be reviewed at the affected supplier, retail, and distributor level. Distributor will be asked to explain or document how they reasonably attempted to notify all their retailers of the price.

In addition, random audits should be conducted to routinely review records at the distributor and retail locations. Approximately 10 percent of the retailers and distributors will be randomly audited per year to verify compliance.

RULE CHANGES

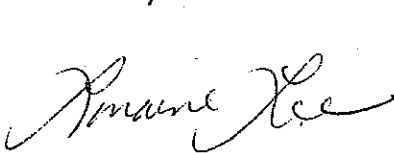
- New rule stating requirement for Distributors to "reasonably" notify all their retailers of available price and retain documentation to show how the communication occurred.
- Revise rule to change requirement for records to be available on-site for faster review. Also extend the records retention to four years. (WAC 314-11-095, WAC 314-20-015, WAC 314-20-050, WAC 314-24-100, 314-24-150)
- Revise rules to increase penalties for violations. (WAC 314-29-025, WAC 314-29-030, WAC 314-29-035)

RESOURCE AND BUDGET IMPLICATIONS

Modify the electronic price filing system to allow changes to be made as needed (without hold period) by suppliers and distributors. In addition, create reporting queries to generate reports to identify possible issues to investigate.

Hire two Auditors to reside in the Enforcement Office. These Auditors will be dedicated to conducting random audits to monitor uniform pricing, minimum mark up, ban on quantity discounts, ban on credit, delivered pricing, and ban on central warehousing. Current Liquor Enforcement Officers (LEO) will conduct investigations based on trend report data and complaints.

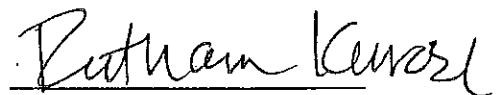
The Liquor Control Board recommended next steps are hereby approved.



Lorraine Lee, Chairman



Roger Hoen, Board Member



Ruthann Kurose, Board Member

April 4, 2008

Date

Modified Electronic Price File System – Data Collection and Investigation Tool

